

Overview and Initial Issues Identification SEATTLE CITY LIGHT

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Table 1: Functional Breakout of Proposed Budget

	2010 Adopted Budget	2011 Proposed Budget	% Chg from '10 Adopted	2012 Proposed Budget	% Chg from '11 Proposed
Expenditures					
Non-Power O&M	\$234,007,683	\$256,805,349	9.7%	\$260,346,912	1.4%
Purchased Power	\$405,347,045	\$347,195,283	-14.3%	\$358,635,217	3.3%
CIP	\$163,557,530	\$197,602,825	20.8%	\$205,320,241	3.9%
General Expense	\$65,765,573	\$68,441,557	4.1%	\$72,677,802	6.2%
Debt & Taxes	\$220,937,949	\$217,499,794	-1.6%	\$251,090,548	15.4%
Total Expenditures	\$1,089,615,780	\$1,087,544,808	-0.2%	\$1,148,070,720	5.6%
Revenues					
Retail	\$614,077,127	\$662,408,870	7.9%	\$698,388,974	5.4%
Wholesale	\$185,435,552	\$173,296,289	-6.5%	\$177,385,612	2.4%
Other Revenues	\$70,339,134	\$69,094,684	-1.8%	\$61,161,968	-11.5%
Transfers from Construction Fund	\$219,763,967	\$182,744,966	-16.8%	\$211,134,165	15.5%
Total Revenues	\$1,089,615,780	\$1,087,544,808	-0.2%	\$1,148,070,720	5.6%
Total FTEs	1,840.10	1,824.50	-0.8%	1,824.50	0.0%

Introduction

Table 1 above breaks City Light's budget into a number of functional areas to facilitate discussion. The 2011-2012 Proposed Budget by Budget Control Level (BCL) is in Table 5 on page 11.

Concurrent with, and supporting the proposed budget, the Mayor is proposing rate increases for City Light of 4.3% in 2011 and 4.2% in 2012. There is Budget Legislation to amend City Light rates.

We begin our discussion by addressing some issues raised by Table 1 to clarify the relationship between the proposed budget and the 2010 Adopted Budget. We then look at the implications of the proposed rates increases that support the proposed spending plan. Next we provide a breakout of proposed additional expenditures and discuss some options to reduce overall expense that the Council may wish to consider.

Overview

Four questions immediately arise from review of Table 1 above:

1. Why is there a rate increase in 2011 when proposed expenditures are down by 0.2% from the 2010 Adopted Budget?
2. Why a 7.9% increase in retail revenue in 2011 when the proposed rate increase is 4.3%?
3. What is included in the proposed 4.3% rate increase?
4. What are the components of the proposed 4.2% rate increase in 2012 and how is that related to the projected 5.6% increase in total revenue?

1. Why is there a rate increase in 2011 when proposed expenditures are down by 0.2%?

The answer to this question is relatively simple if a little odd. The 2011 proposed Purchased Power budget is \$59 million lower than in 2010. This reflects the reality that in the past the budget authority for this activity was significantly in excess of actual need. To be clear, the fact that City Light had a higher Purchased Power budget than it needed **does not** mean that it collected more money from rate payers than it needed. It means, rather, that City Light had more authority to spend on Purchased Power than it had money to support those expenditures. Reducing *excess* expenditure authority does not reduce costs, it simply aligns expenditure authority more closely to both need and the funding available to support the expenditures.

With no other change in City Light's proposed expenditures the \$59 million reduction would reduce its requested budget authority by about 3.3% relative to 2010. However, we can see from the table that the reduction is only 0.2%. The difference reflects real increases in costs relative to 2010 that will require additional rate revenue to support. We will step through those increases later in the discussion.

2. Why is the increase in retail revenue 7.9% in 2011 when the rate increase is only 4.3%?

With assumed load growth, a 4.3% rate increase would raise about \$32 million in additional retail revenue in 2011. Table 1 on page 1, however, shows an increase of around \$48 million (7.9%). Approximately \$12 million of the difference between these numbers is due to the 4.5% surcharge imposed mid-2010 to help build the Rate Stabilization Account (RSA). The RSA, once fully funded at the target level of \$100 million, will act to absorb the variability in net wholesale revenue that has bedeviled the utility (and its customers) in the last two years. Base rate changes in the future will then better reflect policy decisions rather than be driven by variations in wholesale market revenue.

If all goes as planned, that surcharge will be lifted mid-summer. The remainder of the difference is a pass-through of higher costs for the Bonneville Power Administration contract. The Council established the pass-through mechanism to cover small, after-the-fact true-ups in the cost of the contract.

3. What changes in costs go into the 4.3% proposed rate increase?

The next question is the nature of the cost increases that go into the proposed 4.3% rate increase in 2011. There are essentially three main components. Relative to 2010, and excluding the Purchased Power costs already discussed, there is a

- \$22 million increase in operating costs;
- \$34 million increase in capital expenditures;
- \$10 million reduction (relative to 2010) in the assumed amount of net wholesale revenue.

Let us begin with the last item as it is the easiest to explain. When the Council established the Rate Stabilization Account this year, it also established a methodology for calculating the net wholesale revenue that the utility would use for both budgeting and rate setting. The purpose of doing so was to reduce the likelihood of the kinds of overly optimistic forecasts that got the utility into trouble in 2009 and again in 2010. That methodology, based on actual observed net wholesale revenue over the last several years, generated a projected revenue for 2011 that is about \$10 million less than the number assumed in the 2010 Adopted Budget, and hence the 2010 rates.

The same methodology will produce a projection for 2012 that is lower again than the 2011 number, explaining part of the proposed 2012 rate increase. It should be noted that City Light is concerned that these projections are still too high and it would recommend somewhat lower estimates.

Operating Cost Increases: It is important to note that the increase in operating cost in 2011 is a net number. It reflects increases in some areas relative to the 2010 Adopted Budget and cuts in other areas.

About a third of the \$22 million increase in operating costs in 2011 pays for non-discretionary items like:

- higher City and state taxes;
- higher pension and healthcare insurance costs;
- higher central City service costs (mainly for IT);
- new federal regulatory requirements and fees; and
- a COLA adjustment for bargaining units that are not participating in the Citywide agreement to forgo the full 2%. Members constitute over a third of City Light's workforce.

Another third is to restore maintenance on generating and distribution plant that was deferred in 2009 and 2010 to deal with the severe shortfalls in net wholesale revenue. Much of the cost of the work shows up in the capital program, but there is a necessary increase in operating expenses to support the capital expenditures.

The proposed budget restores funding for Conservation to meet the Five-Year Plan adopted by the Council in 2008. As with other programs, it was cut in 2009 and 2010 to help address the revenue shortfall. The add is \$1.2 million.

The balance of the operating cost increase, about \$6 million, is for new systems to improve efficiency.

Capital Spending Increases: The proposed capital spending plan also reflects additions and reductions relative to 2010. Additions to capital expenditures in 2011 total \$58 million, however, there are \$24 million in cuts and deferrals resulting in a net increase over 2010 of only \$34 million. About \$30 million of the 2011 increase is for utility relocation to facilitate the removal of the Alaska Way Viaduct.

4. *What is in the proposed 2012 4.2% rate increase?*

Of the \$41 million increase in operating costs between 2011 and 2012, \$30 million is from increased debt service. City Light plans to issue around \$210 million in new debt in 2011 to support the capital program. This level of borrowing is appropriate given the size of the capital base City Light maintains and is consistent with the financial policies the Council established for it. There is Budget Legislation to authorize the bond sale.

Another \$7 million is to cover a continuation of the non-discretionary costs detailed in the bulleted list above for 2011.

The remainder is made up of lower assumed net wholesale revenue (as noted earlier) and continuation of some of the restored cuts in 2011.

On the capital side, \$44 million of the increase in 2012 is for utility relocation to facilitate the removal of the Alaska Way Viaduct.

We describe the 2011 and 2012 additions to both capital and operating and maintenance costs in Table 4 on page 7 and discuss options the Council may wish to consider to reduce costs.

Rate Increase Impacts

Table 2 below shows the impacts of the two proposed rate increases on City Light's base rates, and also shows the effect of the surcharge. City Light's current assumption is that it will be able to reduce the surcharge from 4.5% to 3.0% by May 1 of 2011 and remove it completely by August 1. Those target dates will likely be delayed if net wholesale revenue is below that assumed in the budget, and if the shortfall is large enough the surcharge may remain in place through 2011.

Even with the proposed 4.3% increase, City Light base rates will be below those of neighboring utilities except Tacoma.

Table 2: Rate Impacts

	Base Rate Adjustment	Cents/kWh	With 4.5% Surcharge
2010 Rate Increase	13.8%		
2010 Base Rate		6.54	
2010 Estimated Rate			6.89
2011 Proposed Increase	4.3%		
2011 Base Rate		6.88	
2011 Estimated Rate			7.19
2012 Proposed Increase	4.2%		
2012 Base Rate		7.30	
2012 Estimated Rate			N/A*

* The surcharge will be gone by August 1 assuming net wholesale revenue is at or above target.

In Table 3 we show the monthly bills and bill impacts of the proposed rate increase for 2011 for representative customers. The High Demand customer is what we usually think of as industrial customers. Assuming that the surcharge is lifted completely by August 1, customer bills would actually be lower at the point *even with the proposed 4.3% rate increase* than they are now.

Table 3: Representative Bills

	Monthly Bills			
	Current Bill	Proposed 2011 Bill with Surcharge	Increase	Proposed 2011 Bill without Surcharge
Residential	\$51.19	\$53.39	\$2.20	\$51.09
Small Business	\$107	\$112	\$5	\$107
Medium Business	\$338	\$354	\$15	\$338
Large Business	\$166,254	\$173,433	\$7,179	\$165,965
High Demand	\$960,746	\$1,002,331	\$41,585	\$959,168

Budget Analysis and Options

Over the last two years City Light has received \$144 million less in wholesale revenue than it had planned. The 13.8% rate increase that the Council granted at beginning of 2010 covered less than half of that. The remainder has been made up through cuts in operations and maintenance and capital spending beginning in early 2009 when the revenue shortfall first became evident, and continuing through this year. The utility also borrowed more in 2010 than it had originally planned and will borrow a little earlier in 2011 than originally planned.

If the Council chooses to reduce the rate increase, the following rule of thumb will help in thinking about what it will require. It takes around \$6.5 million in cuts to operations and maintenance to lower rates by 1%, or equivalently, cuts of about \$75 million to the capital program. It takes such large cuts to capital spending because much of it is debt financed, so only the debt service is saved when it is cut.

Two additional observations will be helpful here. First, although City Light's total budget is just over a billion dollars, its discretionary operating budget is closer to \$180 million, of which over \$100 million is labor costs. A \$6.5 million cut (1% on the rates) translates into a 3.5% cut to operations and maintenance; if the cut is mainly to labor cost, it represents about a 5% cut.

Second, City Light's total 2011 capital program is \$197 million. Over \$40 million of that is for non-discretionary, transportation-related relocations (mostly for the Alaska Way Viaduct). Even if the Council were to eliminate the rest of the capital program it would only reduce the rate increase by about two percentage points.

Table 4 below shows only the main components of the cost increments for 2011 and 2012 in both operations and maintenance (O&M) and the capital program (CIP). It gives the Council a sense of the cost savings that are possible should it decide to cut some of the additions, and the areas that would be impacted by those cuts. We identify several options below for cost savings; they are not mutually exclusive.

Option 1

Cut some, or all, of the additions in Table 4 for Generation and Distribution facilities maintenance (Categories A & B).

In nearly every case, the additions in these two categories are really restorations of cuts and deferrals that City Light took last year and this year to deal with two consecutive years of significant shortfalls in net wholesale revenue. Deferring maintenance always presents risks; however, it may be possible for the utility to re-align priorities to achieve savings.

(Note: the bulk of the money in "Distribution Other" is to cover reimbursable joint use agreements work.)

Items for consideration include reduced generation facility maintenance (#1) reduced vegetation management (#5).

Potential cost reductions: up to \$3.3 million in O&M in 2011.

Table 4: Major 2011-2012 Adds

		2011		2012	
		O&M	CIP	O&M	CIP
Generation Maintenance (A)	1) Generation facility maint.	4,028,000	-	2,110,000	-
	2) Transformer maint.	136,000	-	120,000	-
	3) Ross rock slide project	-	2,600,000	-	1,200,000
	4) Boundary relicensing	(810,000)	500,000	4,090,038	500,000
	Generation Other	60,000	-	60,000	-
Distribution Maintenance (B)	5) Vegetation management	1,990,000	-	1,900,000	-
	6) Cable injection program	200,000	5,608,000	200,000	5,608,000
	7) Wood pole replacement	-	4,000,000	-	7,000,000
	8) Station transformer repl.	180,000	-	180,000	-
	9) Dist. system planning	430,000	-	1,016,940	-
	Distribution Other	2,065,295	1,431,396	1,835,355	1,064,347
Utility Systems and IT (C)	10) Meter reading software repl.	-	300,000	-	350,000
	11) Transformer Mgmt software	100,000	1,000,000	-	-
	12) Asset management program	2,464,000	-	1,750,000	-
	13) CCSS maintenance	275,000	540,000	-	-
	14) Software license & costs	5,118,991	1,000,000	(2,175,833)	-
	Systems Other	640,000	523,955	892,800	3,492,841
Regulatory Compliance (D)	15) FERC license feeds	508,304	-	622,363	-
	16) NERC Compliance	608,184	145,000	457,000	145,000
	17) Cyber security for EMS	207,000	-	-	-
	18) BPA Slice contract interface	140,000	-	50,000	-
	19) Power marketing software	112,250	-	112,250	-
	Regulatory Other	207,400	-	177,400	-
Conservation	20) Conservation Five Year Plan	1,229,000	-	2,994,913	-
	Conservation Other	800,000	-	800,000	-

Option 2

Cut some, or all, of the additions in Table 4 for Utility Systems & IT and Regulatory Compliance (Categories C & D).

Although all of the proposed additions are worthy in their own right, in the interests of keeping costs down, at least in the near term, the Council may wish to consider reducing the funding for some of the IT systems, or deferring them to 2012 or beyond. Items for consideration include delay of the unified GIS system (Systems Other) and reduced effort on asset management (#12).

Potential cost reductions: up to \$3.0 million in O&M in 2011.

Option 3

Cut some, or all, of the additions in Table 4 for the Five-Year Conservation Plan.

In 2008, at the Council's direction, the utility presented a five year plan to rebuild City Light's conservation resource. The Council provided budget authority to implement the plan, but two consecutive years of large shortfalls in wholesale revenue stressed the utility and the plan has not been fully funded. Conservation is, by policy, City Light's resource of choice in meeting its needs. It is also its cheapest resource.

Staff's recommendation is that the Council preserve this addition.

Staff further recommends that the Council consider transferring a portion of the additional funding slated for the Conservation and Environmental Affairs BCL to the Financial Service BCL to support the measurement and verification component of the original conservation plan. During the cutbacks, this component, which is important to the long-term health of the conservation resource, was shelved to minimize the impact of the cuts on the actual acquisition of conservation. The size of the funding transfer is likely to be small in comparison to the overall add, and should be determined in consultation with the utility. If the Council supports this action it should also consider a Statement of Legislative Intent to clarify its desire to see the utility establish an independent measurement and verification function.

Option 4

Cut some existing vacant positions.

City Light has over 25 positions funded at around \$3 million that have been vacant for 18 months or more. If the utility has functioned for that long without them, it is difficult to see why they are necessary at all.

Cutting vacant positions has the advantage that it (a) does not require layoffs that are a hardship for those affected, (b) is less disruptive to the utility than cutting filled positions, (c) is less likely to result in service cuts, and (d) does not result in higher unemployment with the resultant drag on the local economy.

Staff's recommendation is that the Council cut the positions and reduce the labor budget accordingly. Permanent potential savings: up to \$3 million in O&M.

Option 5

Ask the Executive to find workforce efficiencies.

At a more general level, since labor costs generally account for more than 60% of City Light's controllable operating and maintenance costs, the Council may want to consider ways to encourage greater efficiency in the future. Although this will not have an impact on the currently proposed budget, it may prove useful in controlling future budget and rate increases. One approach would be for the Council to issue a Statement of Legislative Intent asking the Executive to identify workplace efficiencies at City Light with a view to controlling costs while continuing to provide good customer service.

Staff's recommendation is that the Council support this option.

Disposition of Savings

Before discussing the best use of any cost savings from the identified cuts, it is important to recognize that many of the cuts identified for 2011 are not sustainable. Deferring maintenance will produce a bow-wave effect in the future, whether that is 2012 or later. If the Council decides to reinstate the cuts in 2012, the rate increase between 2011 and 2012 will need to be larger than that currently proposed.

If the Council pursues the cuts in 2011, the total potential savings are approximately \$9 million. It would then have several options for how to use the savings.

Lower Rates: It could use the savings to reduce rates. Cuts of \$9 million would allow the Council to reduce the rate increase in 2011 to about 3%. That would reduce the bill impacts shown in Table 3 (on page 5) by about a third.

One disadvantage with this approach is that it will require a rate increase in 2012 of around 5.4% to fund the increment proposed in the 2012 budget instead of the 4.2% proposed by the Mayor because the 2011 base would be lower. To be clear, **rates** in 2012 would be lower than proposed in the budget, but the **rate increase** from 2011 to 2012 would be higher.

Augment the RSA: An alternative course of action would be to use the savings to boost the Rate Stabilization Account. The more quickly the Account reaches its target, the sooner the 4.5% surcharge comes off. City Light's projections are that the surcharge will be lifted mid-summer. But that requires that net wholesale revenues will come in as assumed in the budget. As already noted, the utility has argued that the forecast it is required (by ordinance) to assume for both budget and rates for 2011 is too high—as of writing, by about \$12 million. If it is right, then it will be forced to draw on the Rate Stabilization Account to make up the shortfall and the surcharge will continue beyond mid-summer. The savings just about offset the projected gap.

The Council may consider it preferable in the long run to forgo the rate reduction these cuts would

afford in favor of advancing its major policy initiative to insulate both the utility and its customers from the vagaries of the wholesale power market.

Do Both: Another approach would be to reduce the rate increases by some amount and put the rest toward lowering the net wholesale revenue assumed in the budget.

Other Changes that Do Not Warrant Analysis as “Issues” (optional):

None.

Additional Information Needed from Department (optional):

None.

Table 5: 2011-2012 Proposed Budget by BCL

Budget Control Level	2009 Actuals	2010 Adopted	2011 Proposed	% Change '10-'11	2012 Proposed	% Change '11-'12
Expenditures by BCL						
O&M:						
Office of Supt.	\$3,153,000	\$3,123,000	\$2,877,000	-7.9%	\$2,917,000	1.4%
Customer Service	\$27,024,000	\$26,880,000	\$27,819,000	3.5%	\$28,488,000	2.4%
Distribution	\$65,286,000	\$61,625,000	\$69,103,000	12.1%	\$72,569,000	5.0%
Power Supply	\$59,549,000	\$60,738,000	\$66,695,000	9.8%	\$70,020,000	5.0%
Conservation/Envir.	\$50,901,000	\$46,168,000	\$48,130,000	4.2%	\$50,070,000	4.0%
Financial Svcs.	\$26,296,000	\$28,929,000	\$35,298,000	22.0%	\$29,473,000	-16.5%
Human Resources	\$5,624,000	\$6,544,000	\$6,883,000	5.2%	\$6,810,000	-1.1%
<i>Non-Power O&M</i>	<i>\$237,833,000</i>	<i>\$234,007,000</i>	<i>\$256,805,000</i>	<i>9.7%</i>	<i>\$260,347,000</i>	<i>1.4%</i>
General Expenses	\$67,185,000	\$65,766,000	\$68,442,000	4.1%	\$72,678,000	6.2%
Purchased Power	\$297,442,000	\$405,347,000	\$347,195,000	-14.3%	\$358,635,000	3.3%
Debt Service	\$216,839,000	\$150,693,000	\$142,659,000	-5.3%	\$173,113,000	21.3%
Taxes	\$62,575,000	\$70,245,000	\$74,841,000	6.5%	\$77,978,000	4.2%
CIP:						
Cust Svc/Energy Del.	\$130,535,000	\$110,902,000	\$133,295,000	20.2%	\$153,373,000	15.1%
Power Supply/Envir.	\$47,224,000	\$46,264,000	\$57,846,000	25.0%	\$43,973,000	-24.0%
Financial Svcs.	\$6,964,000	\$6,392,000	\$6,462,000	1.1%	\$7,974,000	23.4%
Total	\$1,066,597,000	\$1,089,616,000	\$1,087,545,000	-0.2%	\$1,148,071,000	5.6%
Total FTEs	1841	1841	1824	-0.9%	1824	0.0%
Revenues						
Retail Customers	\$545,111,000	\$614,077,000	\$662,409,000	7.9%	\$698,389,000	5.4%
Wholesale	\$127,027,000	\$185,436,000	\$173,296,000	-6.5%	\$177,386,000	2.4%
Other	\$60,202,000	\$70,339,000	\$69,095,000	-1.8%	\$61,162,000	-11.5%
Debt	\$334,257,000	\$219,764,000	\$182,745,000	-16.8%	\$211,134,000	15.5%
Total Revenues	\$1,066,597,000	\$1,089,616,000	\$1,087,545,000	-0.2%	\$1,148,071,000	5.6%